EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES) (AMENDMENT) (NO.2) ORDER 2013

No.

AND

THE FINANCIAL SERVICES ACT 2012 (CONSUMER CREDIT) ORDER 2013

No.

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These instruments will affect the transfer of consumer credit regulation from the Office of Fair Trading to the Financial Conduct Authority.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 ("the RAO Order") will be made under sections 22 and 428 of, and Schedule 2 to, the Financial Services and Markets Act 2000. It will also be made (in connection with article 12 of the Order) under section 2(2) of the European Communities Act 1972. The Financial Services Act 2012 (Consumer Credit) Order 2013 ("the Consumer Credit Order") will be made under sections 107 and 115 of the Financial Services Act 2012.

5. Territorial Extent and Application

5.1 These instruments apply to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 and the Financial Services Act 2012 (Consumer Credit) Order 2013 are compatible with the Convention rights.

7. Policy background

7.1 These instruments effect the transfer of consumer credit regulation from the Office of Fair Trading ("OFT") to the Financial Conduct Authority ("FCA").

7.2 The RAO Order is concerned with making the necessary changes to the Financial Services and Markets Act 2000 ("FSMA") and associated secondary legislation to bring credit related activity into the scope of FCA regulation and to ensure that certain features are modified to fit the credit sector. The Order also makes consequential amendment to other legislation including extensive amendments to the Consumer Credit Act 1974 ("CCA") in relation to the functions of the OFT under that Act. Substantive provisions of the CCA that can be replicated by rules made by the FCA under Part 9A of FSMA are also repealed.

7.3 The Consumer Credit Order gives effect to the Government's proposed approach in relation to the CCA to ensure that retained provisions of the CCA continue to apply appropriately and can be effectively enforced. The Order also ensures that local weights and measures authorities and, in Northern Ireland, the Department of Enterprise, Trade and Investment can continue to take effective enforcement action in relation to those who carry on credit related activities without the appropriate regulatory approval.

7.4 The Government believes that there should be fundamental reform of the regulatory regime for consumer credit to better protect consumers engaging with this market. The Government's vision is that consumer credit regulation:

- Is able to flex to keep pace with a fast-growing innovative market;
- Has the powers and resources to protect consumers from actual and potential detriment;
- Puts a proportionate burden and manageable burden on business, and is tailored to the unique nature of consumer credit markets; and
- Delivers a well-functioning market which meets consumers' needs.

Transferring responsibility for consumer credit regulation to the FCA will mean that for the first time conduct of business regulation of all retail financial services will be under one roof.

7.5 The Government proposes to apply an approach to regulating the consumer credit market based on the powers and requirements set out in FSMA, but a number of conduct of business requirements and other provisions in the CCA will continue to apply. This reflects that the Government's view that the conduct requirements enshrined in the current regime are broadly fit for purpose (though some targeted additions are likely to be

needed) but the current limitations on how compliance with those standards is enforced need to be addressed in order to tackle consumer detriment. This approach is intended to ensure continuity for firms and make compliance burdens more manageable.

7.6 The authorisation process is central to a FSMA approach, and authorisation will replace the current licensing regime under the CCA. All firms carrying on a credit-related regulated activity will in future need to be authorised (under Part 4A of FSMA) unless they are exempt or are covered by one of the specialist regimes in FSMA (for example, Part 20 which relates to members of certain designated professional bodies).

7.7 The Government is committed to designing a tailored and proportionate regime; it has therefore designed a two-tier approach to authorisation. Certain firms which carry on credit activity as secondary to their main business or firms which carry on certain lower risk activities will be eligible for the "limited permission" regime. In particular the threshold conditions these firms will have to meet have been modified (see the amendments made to Schedule 6 to FSMA by article 10 of the RAO Order). In addition, the appointed representatives regime will be open to consumer credit firms (except most lenders) as an alternative to direct regulation by the FCA (see the amendments made to S.I. 2001/1217 by article 15 of the RAO Order).

7.8 The Government has also provided for an interim permissions regime (see articles 58-61 of the RAO Order), which will help to smooth the transition from regulation under the CCA to regulation under FSMA. Interim permissions will be based on firms' existing consumer credit licences. This has been designed to enable firms to transfer into the FSMA regime first and adapt to a new regulatory regime before then seeking full authorisation at a later date.

7.9 The scope of regulation is largely unchanged and in general existing exemptions under the CCA will continue to apply. However, the activity of operating a peer to peer platform will now be covered by a new, bespoke regulated activity (see new article 36G of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("the Regulated Activities Order") as inserted by article 4 of the RAO Order), and the Government proposes to exempt from regulation the activity of tracing debtors as carried on by third party tracing agents (see new article 54 of the Financial Services and Markets Act 2000 (Exemption) Order 2001 as inserted by article 14 of the RAO Order). In addition, the Government proposes to narrow the definition of operating a credit reference agency to ensure that only those whose business relates primarily to the provision of credit references are subject to regulation (see new article 89B of the Regulated Activities Order as inserted by article 8 of the RAO Order), and incorporate the activity of credit intermediation into the activity of credit brokerage in order to simplify the regime for consumers (see the new article 36A of the Regulated Activities Order as inserted by article 4 of the RAO Order).

7.10 A key benefit of the transfer is the application of the FCA's broad and flexible enforcement toolkit to the consumer credit market. This will mark a considerable strengthening of regulatory enforcement powers to punish misconduct by consumer credit

firms. The Consumer Credit Order also provides for the FCA to exercise its enforcement powers under FSMA in response to breaches of the CCA.

8. Consultation outcome

8.1 These instruments were subject to full public consultation in the document "A new approach to financial regulation: transferring consumer credit regulation to the Financial Conduct Authority", which was published on the HM Treasury website on 6 March 2013. The consultation closed on 1 May 2013, in line with Government guidance on public consultation. A summary of consultation responses will shortly be published on www.gov.uk. The summary of responses also sets out how Government has adjusted its approach in view of issues raised by consultation respondents.

8.2 Consultation respondents generally supported the proposed approach and felt that the Government has broadly struck the right balance between consumer protection and a proportionate approach. Some industry respondents raised concerns about the timetable for the transfer. Some also highlighted the impact of limitations on firms holding interim permission and the Government has therefore provided for greater flexibility in view of these issues.

8.3 Industry and consumer groups broadly supported the proposal to repeal some parts of the CCA, while retaining others where they could not be easily replicated in FCA rules. The limited permission regime was also widely welcomed, although there were a range of views on which activities should be eligible for the limited permission regime.

8.4 Proposed changes to the scope of regulation were broadly welcomed, though some firms sought further exemptions, while consumer groups and some industry representatives sought that effecting an introduction to debt advice should be made a new regulated activity. The Government does not have sufficient evidence to support regulation in this area but will keep this issue under review.

8.5 The proposals on enforcement were widely supported.

9. Guidance

9.1 Further guidance will be made available by the FCA.

10. Impact

10.1 The impact on business, charities or voluntary bodies is set out in the accompanying impact assessment. The Government's best estimate of the total cost to business of the new regulatory regime is £336million over 10 years (at 2013 prices). The Government's best estimate of benefits of the regime is £689million over 10 years. The estimated net benefit over 10 years is £353million.

10.2 The impact on the public sector is not quantified. Public sector organisations are largely exempt from consumer credit regulation. The Government is conducting a further

consultation exercise to establish the extent of unsecured lending undertaken by local authorities and similar organisations and, if appropriate, suitable regulatory arrangements.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the regulatory regime for consumer credit has been designed so that small firms will be subject to proportionate and manageable burdens:

- Many small firms will be able to take advantage of the limited permission regime which will impose lower costs and reduced administrative requirements on eligible firms;
- Small firms (except lenders which apply interest and charges to loans) will have the option to become an appointed representative, as a way for smaller firms to operate without having to shoulder the burden of direct authorisation and regulation;
- Consumer credit firms will not be subject to minimum capital requirements (except where they undertake debt management business);
- Existing exemptions from regulation for agents of mail order firms and home credit providers will continue;
- Firms which specialise in finding or tracing individuals, where these are not carrying on a financial services business will be removed from the scope of regulation; and
- In addition, the FCA proposes to introduce a differenced fee charging system, which will reflect the size of firms.

11.3 The basis for the final decision on what action to take to assist small business is ensure that small businesses gain from the reputational benefits of a better-regulated and well-functioning market and to ensure that small businesses are subject to appropriate and proportionate regulatory burdens. The Government has decided against exempting small business from this policy, as its objective is to strengthen consumer protection across the consumer credit market.

12. Monitoring & review

12.1 HM Treasury will monitor the practical effects of these instruments to ensure they continue to meet the policy aims.

13. Contact

13.1 Laura Hanoman at HM Treasury (tel: 0207 270 5507 or email: laura.hanoman@hmtreasury.gsi.gov.uk) can answer any queries regarding the instrument.